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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1961

No. 600

ARD E. RICHARDSON, JR., and MILDRED G. RICHARDSON; and PETER C. TRELEAVEN, individually, and PETER C. TRELEAVEN, ARD E. RICHARDSON, JR., and WILBER M. SEELYE, as Co-Executors of the Estate of IRENE B. TRELEAVEN, Deceased,
Petitioners,
vs.
THE UNITED STATES OF AMERICA,
Respondent

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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No.....

ARD E. RICHARDSON, JR., and MILDRED G. RICHARDSON; and PETER C. TRELEAVEN, individually, and PETER C. TRELEAVEN, ARD E. RICHARDSON, JR., and WILBER M. SEELYE, as Co-Executors of the Estate of IRENE B. TRELEAVEN, Deceased,
Petitioners,

vs.

THE UNITED STATES OF AMERICA,
Respondent

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petitioners Ard E. Richardson, Jr., and Mildred G. Richardson; and Peter C. Treleaven, individually, and Peter C. Treleaven, Ard E. Richardson, Jr., and Wilber M. Seelye, as Co-Executors of the Estate of Irene B. Treleaven, Deceased, pray that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the Sixth Circuit entered in the above entitled case September 19, 1961.

## CITATIONS TO OPINIONS BELOW

The opinion of the District Court in *Richardson et al. v. The United States of America* is reported at 177 F. Supp. 394 (R. 22a-27a) and Appendix B, *infra*, pages 21 to 26.[1] The opinion of the Court of Appeals for the Sixth Circuit is as yet unreported; but said opinion is printed in Appendix C, *infra*, pages 28 to 36.

## JURISDICTION

The judgment of the Court of Appeals for the Sixth Circuit was entered September 19, 1961. (Appendix C, *infra*, page 36.) The jurisdiction of this court is invoked under 28 U.S.C., Section 1254.

## QUESTION PRESENTED

Whether Section 126(a) of the Internal Revenue Code of 1939, as amended, is unconstitutional as a direct tax on capital in violation of Article I, Section 2(3) and Article 1, Section 9(4) of the Constitution of the United States of America.

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[1] The record submitted by Petitioners to the United States Court of Appeals for the Sixth Circuit was printed in the form of an Appendix. Petitioners will indicate references to that Appendix as "R. —a." References to the appendices to the instant petition will be indicated as "Appendix —, *infra*, p. —."

## CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The constitutional provisions involved are Article I, Section 2(3), Article I, Section 9(4) and Article XVI. The statutory provisions involved are Sections 22(b)(3), 113 (2) (5) and 126(a) and 126(c) of the Internal Revenue Code of 1939, as amended. The constitutional and statutory provisions are printed in Appendix A, *infra*, pages 17 to 20.

## STATEMENT OF THE CASE

(1) Ard E. Richardson, a resident of Lansing, Michigan, died testate September 21, 1945, leaving as his surviving heirs his widow, Irene B. Richardson, and his son, Ard E. Richardson, Jr., Irene B. Richardson later married Peter C. Treleaven (R. 14a).

(2) The Last Will and Testament of Ard E. Richardson was duly admitted to probate by the Ingham County, Michigan, Probate Court, and Letters Testamentary were granted to his widow, Irene B. Richardson, November 13, 1945 (R. 14a).

(3) Within the time provided by law, Irene B. Richardson filed with the said Probate Court her election to take her share of the estate, as provided by section 69, Chapter II, Michigan Probate Code, Section 702.69, Compiled Laws of Michigan (1948). Pursuant to such election, Irene B. Richardson became entitled under the Michigan Statute of Descent and Distribution to one-fourth and Ard E. Richardson, Jr. became entitled to three-fourths of the net residue of the estate (R. 14a).

(4) Seven promissory notes with accrued interest were included in the probate estate and in the gross estate of the decedent for Michigan inheritance tax and federal estate tax purposes in the total amount of $139,000 of principal and $411,593.33 of accrued interest as of the date of death, and a Michigan inheritance tax and federal estate tax were paid thereon (R. 14a-15a).

(5) The federal estate tax assessed against and paid by the estate on account of the inclusion in the gross estate of the said accrued interest of $411,593.33 was $129,534.25, or thereabouts (R. 16a).

(6) On February 16, 1948, the Probate Court entered an order which approved distribution of the seven promissory notes plus the then accrued interest as a partial distribution of the residue of the estate. The distribution was on the basis of three-fourths to Ard E. Richardson, Jr. and one-fourth to Irene B. Treleaven (R. 15a).

(7) On June 11, 1948, the seven promissory notes in the principal amount of $139,000, plus the then accrued interest of $426,179.68, were paid. Ard E. Richardson, Jr. received $104,250 of principal and $319,634.76 of accrued interest, and Irene B. Treleaven received $35,750 of principal and $106,544.92 of accrued interest (R. 15a).

(8) $411,593.33 of the said accrued interest of $426,179.68 was attributable to interest accrued to Ard E. Richardson, as of the date of death, of which amount Ard E. Richardson, Jr. received $308,695 and Irene B. Treleaven received $102,898.33 (R. 16a).

(9) Ard E. Richardson, Jr. and Mildred Q. Richardson and Peter C. Treleaven and Irene B. Treleaven, by her executors, included in their respective 1948 individual income tax returns the said amounts of $308,695 and $102,898.33, respectively, as income in respect of a decedent

under section 126(a) of the Internal Revenue Code of 1939, as amended; and they claimed in their respective 1948 income tax returns a deduction under section 126(c) of the Internal Revenue Code of 1939, as amended, in the amounts of $92,980.50 and $30,993.50, respectively, for federal estate taxes paid by the Estate of Ard E. Richardson, Deceased, on the said accrued interest of $411,593.33 (R. 16a-17a).

(10) Ard E. Richardson, Jr. and Mildred Q. Richardson and Peter C. Treleaven and Irene B. Treleaven, by her executors, respectively, duly filed refund claims September 25, 1950 on the ground that the said accrued interest included in their 1948 income tax returns was exempt from income tax under section 22(b)(3) of the Internal Revenue Code of 1939, as amended, as a bequest, devise, or inheritance; that the income tax cost basis of the said accrued interest under section 113(a)(5) of the Internal Revenue Code of 1939, as amended, is the fair market value of said accrued interest as of the date of death of Ard E. Richardson; and that section 126(a) of the Internal Revenue Code of 1939, as amended, is unconstitutional as a direct tax on capital (R. 17a-18a).

(11) The refund claims were denied; and suit for refund was timely filed. Jurisdiction of the United States District Court was based upon Title 28 U.S.C. Section 1346. The District Court entered judgment for the United States of America (R. 28a-29a) and the Court of Appeals for the Sixth Circuit affirmed (Appendix C, *infra* p. 36).

## REASONS FOR GRANTING THE WRIT

This case involves the constitutionality of Section 126(a) of the Internal Revenue Code of 1939, as amended, Section 126(a) imposes a direct tax on capital contrary to the Constitution of the United States of America and its continued enforcement threatens our national concept of no direct taxation without apportionment among the several states.

Section 126(a) represents the second statutory attempt to prevent tax avoidance caused by the fact that under state common law, income accrued to a cash basis decedent is received as capital by his estate or heirs. Such items were not taxable to the cash basis decedent because they were not received before death, and they were not taxable to the estate or heirs upon receipt because they were received as capital. *Nichols v. U. S.*, 64 Ct. Cl. 241; cert. den. 277 U. S. 584; *Dobbins v. Commissioner*, 31 F. 2d 935; *Vanderbilt*, 11 B. T. A. 291; *Doehne*, 6 B. T. A. 1061; *Estae of Heller*, 10 B. T. A. 53; *Estate of Austin*, 10 B. T. A. 1055; *Auchincloss, Exec.*, 11 B. T. A. 947; *Blodget et al., Exec.*, 13 B. T. A. 1243; *Kemper, Admr.*, 14 B. T. A. 931; and *Goldman*, 15 B. T. A. 1341.

The first statute, Section 42 of the 1934 Revenue Act,[2] solved the problem by placing cash basis decedents on the

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[2] "Sec. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as to a different period. In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period."

accrual basis for their final income tax return; the second statute, Section 126(a) of the 1942 Revenue Act, solved the problem by defining such capital items as income to the estate or heirs for federal income tax purposes. The first statute was burdensome but constitutional (*Helvering v. Enright's Estate*, 61 S. Ct. 777); the second statute was less burdensome but unconstitutional. The first statute created hardships because it bunched in the final income tax return accrued income which might never be collected; the second statute was enacted to relieve this hardship by taxing such items to the estate or heirs as received.

The enactment of Section 126(a) as a relief provision has obscured its unconstitutional concept and has tended to encyst this statute from the constitutional scrutiny; but legislative paternalism does not justify unconstitutional legislation. Section 126(a) imposes an income tax on capital contrary to the Constitution of the United States of America and the fact that it was intended as a relief provision is immaterial.

The United States Supreme Court held in *Pollock v. Farmers Loan & Trust Co.*, 157 U. S. 429, that the Income Tax Act of August 15, 1894 (28 Stat. 509, C. 349) was unconstitutional as a direct tax without apportionment. Later the 16th Amendment to the Constitution of the United States of America gave Congress the power to lay and collect direct taxes on income without apportionment, but all other direct taxes, including taxes on capital as distinguished from income, are unconstitutional without apportionment. (*Eisner v. Macomber*, 252 U. S. 189.) Constitutional distinctions between capital and income are meaningless, if Congress can define capital to mean income under the Internal Revenue Code.

It is axiomatic that Congress cannot levy an income tax on capital merely by calling it income. In *Hoeper v. Tax Commissioner of Wisconsin*, 284 U. S. 206, the United States Supreme Court held that "* * * That which is not in fact the taxpayer's income cannot be made such by calling it income." In *Eisner v. Macomber, supra*, the United States Supreme Court held:

> "In order, therefore, that the clauses cited from article I of the Constitution may have proper force and effect, save only as modified by the amendment, and that the latter also may have proper effect, it becomes essential to distinguish between what is and what is not 'income', as the term is there used, and to apply the distinction, as cases arise, according to truth and substance, without regard to form. *Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution, from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised.*" (Italics added.)

No federal statute can or does define capital or income for federal income tax purposes. The determination of what is capital and what is income for federal income tax purposes depends upon general common law. There is no federal common law (*Erie Railroad Co. v. Tompkins*, 304 U. S. 64); there is only state common law. Under Michigan common law, income accrued to a cash basis decedent is includible in his probate estate as corpus and collected by his estate or heirs as corpus. Federal courts have held that accrued income to a cash basis decedent is corpus to his estate or heirs under state common law. (*Estate of Huesman*, 16 T. C. 656 affirmed on other grounds 198 F. (2d) 133 (C. A.—9); *Rose J. Linde*, 17 T. C. 584, affirmed 213 F. (2d) 1 (C. A.—9); *Estate of Robert L.*

*Clymer*, P-H T. C. Memo 54, 218, reversed 221 F. (2d) 680 (C. A.—3); *Estate of Carruth*, 28 T. C. 871, and *Midland National Bank of Billings v. United States*, 168 F. Supp. 736). Congress also has recognized that income accrued to a cash basis decedent is capital to his estate or heirs under state common law (Senate Finance Report No. 1622, 83rd Cong. 2nd Sess. (1954) page 375).

The simple question involved in this case is whether Congress by legislation may tax as income that which is capital under state common law. It is respectfully submitted that Congress cannot constitutionally define capital to mean income. *(Eisner v. Macomber, supra.)*

Congress unconstitutionally overruled the cases which hold that income accrued to a cash basis decedent is capital to his estate or heirs on the basis of an erroneous interpretation of *Irwin v. Gavit*, 268 U. S. 161 (1925), which erroneous interpretation was first utilized to amend Section 22(b)(3) of the Internal Revenue Code of 1939, as amended, and then to enact Section 126(a).

Prior to 1934 the courts consistently held that accrued income to a cash basis decedent was received by his estate or heirs as a bequest or devise of capital not taxable as income. In *Nichols v. U. S., supra*, the Court of Claims held:

> "• • • The (estate) tax thus imposed upon the transfer of the estate is upon the interest which ceases by reason of the death and is not upon the interest to which legatees and devisees succeed: *Y. M. C. A. v. Davis*, 264 U. S. 47, 50; *Edwards v. Slocum*, 264 U. S. 61. *An interest thus ceases and the estate interest begins at the time of the death. When, therefore, an item is properly determined to constitute a part of the gross estate of a decedent for estate tax purposes it cannot by any sort of reasoning be made to constitute a part of the income*

*of the same estate. It is a part of its corpus. The income of an estate which the statute taxes is, generally speaking, the income which accrues after the estate begins, and it begins with the decedent's death.* * * *" (Italics added.)

As aforesaid Congress enacted Section 42 of the 1934 Revenue Act to place cash basis decedents on the accrual basis for their final income tax return to tax such accrued income to the decedent. The economic hardships caused by Section 42 caused Congress to reconsider this problem and to enact Section 126(a) as a substitute. Congress relied upon an unconstitutional interpretation of *Irwin v. Gavit, supra,* as authority for the enactment of Section 126(a).

*Irwin v. Gavit, supra,* involved an interpretation of Section II, B. of the Income Tax Act of 1913 which provided in part that there is included in income "* * * the income from but not the value of property acquired by gift, bequest, devise or descent: * * *."[3] This provision is the original counterpart of Section 22(b)(3) of the Internal Revenue Code of 1939, as amended, which latter provision is referred to in the congressional reports under Section 126(a).

In *Irwin v. Gavit, supra,* the taxpayer received a bequest of one-half of the future income from a testamentary trust until the testator's granddaughter attained majority whereupon the trust would terminate and pass to the grand-

[3] This provision was reenacted in all subsequent revenue acts, but it was restated as an exclusion provision to exclude from income, "The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income.)" (1924 Revenue Act, Sec. 213(b)(3)).

daughter. The question was whether the bequest of the future income itself, as distinguished from the capital from which the future income is derived, is excluded as a bequest, devise or inheritance under Section II, B. of the Income Tax Act of 1913. The Supreme Court held that the bequest of future income was taxable to the taxpayer reasoning as follows:

> "* * * if a fund were given to trustees for A for life with remainder over, the income received by the trustees and paid over to A would be income of A under the statute. It seems to us hardly less clear that even if there were a specific provision that A should have no interest in the corpus, the payments would be income none the less, within the meaning of the statute and the Constitution, and by popular speech. In the first case it is true that the bequest might be said to be of the corpus for life, in the second it might be said to be of the income. But we think that the provision of the act that exempts bequests assumes the gift of a corpus and contracts it with the income arising from it, but was not intended to exempt income property so-called simply because of a severance between it and the principal fund. * * *
>
> "The courts below went on the ground that the gift to the plaintiff was a bequest and carried no interest in the corpus of the fund. We do not regard those considerations as conclusive, as we have said, but if it were material a gift of the income of a fund ordinarily is treated by equity as creating an interest in the fund. Apart from technicalities we can perceive no distinction relevant to the question before us as between a gift of the fund for life and a gift of the income from it. The fund is appropriated to the production of the same result whichever form the gift takes. * * *"

In the 1942 Revenue Act, Congress amended section 22 (b)(3), the then statutory counterpart of Section II, B. of the Income Tax Act of 1913, to codify *Irwin v. Gavit, supra,* as follows:

> "(b) Exclusions from Gross Income—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:
>
> • • • • •
>
> "(3) *Gifts, bequests, devises, and inheritances.* —The value of property acquired by gift, bequest, devise, or inheritance. There shall not be excluded from gross income under this paragraph, the income from such property, *or in case the gift, bequest, devise, or inheritance is of income from property, the amount of such income.* • • •" (Emphasis added.)

The Congressional Report on the foregoing amendment to section 22(b)(3) states in part as follows:[4]

> "• • • Under existing law, the value of property acquired by gift, devise, or inheritance, but not the income therefrom, is excluded from gross income by the provisions of section 22(b)(3) of the Code. This section has been construed as not requiring the exclusion from gross income of amounts received under a gift, bequest, or devise of a *right to income* from property. *Irwin v. Gavit,* 268 U. S. 161 (1925) (T. D. 3710, C. B. IV-1, 123 (1925). This construction of the existing law is now written into the bill for the sake of clearness." (Italics added.)

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[4] S. Report No. 1631, 77th Cong., 2nd Sess. (1942-2 C. B. 558).

The 1942 amendment to section 22(b)(3) was a codification of existing law, as determined by the United States Supreme Court in *Irwin v. Gavit, supra.* It is perfectly clear that *Irwin v. Gavit, supra,* deals only with the receipt of *future income,* as distinguished from *income accrued as of the date of death.* The taxation of such future income to the recipient is proper because such income accrues as income in the hands of the recipient and not the decedent; but income accrued as of the date of death is capital in the hands of the estate or heirs and cannot constitutionally be taxed as income.

Section 126(a) was enacted in the 1942 Revenue Act at the same time that section 22(b)(3) was amended, as aforesaid. Congress considered section 22(b)(3) as so amended in its deliberations on proposed section 126(a) and concluded as follows:[5]

> "* * * Section 22(b)(3) (excluding from income amounts received by bequest, devise or inheritance) does not apply to these amounts which are specifically required to be included in income. *The right to income is treated in the hands of the decedent differently from his other property and when his estate or his legatee takes his place with respect to this income it is proper to continue to treat this right in their hands in the same manner as it would be treated in the hands of the decedent.*" (Italics added.)

The Congressional Reports, *supra,* state that section 22(b)(3):[6]

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[5] S. Report No. 1631, 77th Cong., 2nd Sess. (1942-2 C. B. 580).

[6] See footnote 4, *supra.*

> "• • • has been construed as not requiring the exclusion from gross income of amounts received under a gift, bequest or devise of a *right to income* from property. *Irwin v. Gavit*, 268 U. S. 161 • • •." (Italics added.)

But as hereinbefore demonstrated, *Irwin v. Gavit, supra,* deals only with *future income* earned after the date of death as distinguished from *accrued income* as of the date of death. It is respectfully submitted that Congress erroneously attributed a much broader scope and meaning to the phrase "right to income" than is justified by *Irwin v. Gavit, supra,* in the enactment of section 126(a). Legislative error is not fatal except where, as here, the result is unconstitutional legislation.

The sophisticated solution under section 126(a) to the taxation of decedent income ignores the decided cases which required the enactment of section 42 of the 1934 Revenue Act. *Nichols v. U. S., supra,* and the related cases cited herein clearly establish that decedent income is received by the estate or heirs as capital and cannot be taxed to them as income.

*Estate of Huesman, supra,* and the related cases cited herein hold that decedent income is capital under general common law, section 126(a) to the contrary notwithstanding. In *Estate of Huesman, supra,* an estate collected a bonus owed to the decedent as of the date of death, which bonus was immediately paid to trustees, who paid it to Loyola University in partial satisfaction of a charitable legacy. The estate reported the bonus as income under section 126(a) and claimed a deduction therefor under section 162 of the 1939 Revenue Act, as amended, which latter section allows a deduction for gross income paid for charitable purposes. *The Government argued* and the *Tax*

*Court held* that such amount was not deductible under section 162 because it was corpus and not income, reasoning as follows:

> "*The claim which decedent's estate had against Desmond's (for the bonus) was at all times part of the corpus of decedent's estate.* The fact that the Congress saw fit to relieve the hardship to a decedent, from an income tax standpoint, by requiring that the amount collected on such claim be reported as income of the decedent's estate, in no wise affects the character of this asset which was fixed and determined at the date of the decedent's death. The subsequent liquidation of the claim merely converted the form of the assets from a chose in action into cash. * * *" (Italics added.)

The opinion of the Tax Court in *Hucsman, supra*, that items included under section 126(a) are corpus and not income, confirms the position of petitioners in this case. A direct tax on capital (corpus) is unconstitutional without apportionment among the several states.

## CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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# APPENDIX A

## CONSTITUTIONAL PROVISIONS AND STATUTES

The Constitution of the United States of America:

*Preamble.* We the People of the United States, in Order to form a more perfect Union, establish Justice, insure domestic Tranquillity, provide for the common defense, promote the general Welfare, and secure the Blessings of Liberty to ourselves and our Posterity, do ordain and establish this Constitution for the United States of America.

ARTICLE I

* * * * *

*House of representatives; qualifications of electors.* Section 2. * * *

* * * * *

*Apportionment of representatives and direct taxes; census; first apportionment.* (3) Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers, * * *.

* * * * *

*Limitations of the powers of Congress; importation of certain persons.* Section 9. * * *

* * * * *

*Same; direct tax.* (4) No Capitation, or other direct Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.

Amendments to The Constitution of the United States of America:

ARTICLE XVI

*Income tax.* The Congress shall have power to lay and collect taxes on incomes from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

Internal Revenue Code of 1939, as amended:

Sec. 22. GROSS INCOME.

* * * * *

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

* * * * *

(3) *Gifts, bequests, devises, and inheritances.*—The value of property acquired by gift, bequest, devise, or inheritance. There shall not be excluded from gross income under this paragraph, the income from such property, or, in case the gift, bequest, devise, or inheritance is of income from property, the amount of such income. For the purposes of this paragraph, if, under the terms of the gift, bequest, devise, or inheritance, payment, crediting, or distribution thereof is to be made at intervals, to the extent that it is paid or credited or to be distributed out of income from property, it shall be considered a gift, bequest, devise, or inheritance of income from property; * * *.

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.* The basis of property shall be the cost of such property; except that—

* * * * *

(5) *Property transmitted at death.*—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the

basis shall be the fair market value of such property at the time of such acquisition. * * *

SEC. 126. INCOME IN RESPECT OF DECEDENTS.

(a) *Inclusion in Gross Income—*

(1) *General rule.*—The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period shall be included in the gross income, for the taxable year when received, of:

(A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent;

(B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or

(C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

* * * * *

(c) *Deduction for Estate tax.—*

(1) *Allowance of deduction.*—A person who includes an amount in gross income under subsection (a) shall be allowed, for the same taxable year, as a deduction an amount which bears the same ratio to the estate tax attributable to the net value for estate tax purposes of all the items described in subsection (a)(1) as the value for estate tax purposes of the items of gross income or portions thereof in respect of which such person included the amount in gross income (or the amount included in gross income, whichever is lower) bears to the value for estate tax purposes of all the items described in subsection (a)(1).

(2) *Method of computing deduction.*—For the purposes of paragraph (1):

(A) The term "estate tax" means the tax imposed upon the estate of the decedent under section 810 or 860, reduced by the credits against such tax, plus the tax imposed upon the estate of the decedent under section 935, reduced by the credits against such tax.

(B) The net value for estate tax purposes of all the items described in subsection (a)(1) shall be the excess of the value for estate tax purposes of all the items described in subsection (a)(1) over the deductions from the gross estate in respect of claims which represent the deductions and credit described in subsection (b).

(C) The estate tax attributable to such net value shall be an amount equal to the excess of the estate tax over the estate tax computed without including in the gross estate such net value.

# APPENDIX B

## OPINION OF DISTRICT JUDGE

(Filed September 25, 1959)

The question here present is a narrow one, and may be stated simply without the necessity for a recitation of all the contents of the stipulation of facts upon which the case has been submitted to the Court for determination. The said stipulation was agreed upon and filed by the parties, and we adopt it as the findings of fact necessary for compliance with Rule 52(a) F. R. Civ. P.

This case involves the application of Section 126 of the Internal Revenue Code of 1939, 26 U. S. C. A. §126, as added by §134, Revenue Act of 1942, C. 619, 56 Stat. 798, the pertinent part of which reads as follows:

"§126. *Income in respect of decedents*

(a) *Inclusion in gross income.*

(1) *General Rule.* The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period shall be included in the gross income, for the taxable year when received, of:

(A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent;

(B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the deceden't estate from the decedent; or

(C) the person who acquires from the decedent the right to receive the amount by bequest, devise or in-

heritance, if the amount is received after a distribution by the decedent's estate of such right.

* * * * *

(3) *Character of income determined by reference to decedent.* The right, described in paragraph (1), to receive an amount shall be treated, in the hands of the estate of the decedent or any person who acquired such right by reason of the death of the decedent, or by bequest, devise, or inheritance from the decedent, as if it had been acquired by the estate or such person in the transaction by which the decedent acquired such right; and the amount includible in gross income under paragraph 1) or (2) shall be considered in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount."

As will appear from the stipulation, the subject matter of this case is the interest accruing to decedent until the date of his death but not collected by him. Plaintiffs here claim that such interest became part of the corpus of the estate and that §126(a) is unconstitutional insofar as it treats this interest item as income rather than as corpus. No argument is made that, had the decedent, during his lifetime, received, or collected, the interest on the notes as said interest became due, it would not have been income subject to the federal income tax. The question, therefore, is whether or not, by postponing the receipt of said interest until some time after his death, a person may, in effect, avoid the impact of the income tax by virtue of the change from income to principal wrought by the fact of his death, and by no other converting circumstance. Section 126(a) is the answer of the United States Congress to this question. The statute answers the question in the negative. It is the contention of the plaintiffs that the statute is unconstitutional. They state in their reply brief, at page 3, that "The ultimate issue in this case is whether §126(a) is unconstitutional as a direct tax on capital contrary to the Constitution of the United States. The subject accrued

interest is clearly capital under Michigan law; and the narrow issue in this case is whether Congress may tax as income under the Sixteenth Amendment what is capital under state law." Plaintiffs concede that §126(a) imposes an income tax but they vigorously contend that the said tax, is in fact, on capital and, therefore, unconstitutional because it constitutes "a direct tax on capital in violation of Article I, §2(3), Article I, §8, and Article I, §9(4) of the Constitution of the United States, because it is not a tax on income under the Sixteenth Amendment to the Constitution of the United States."[1] Plaintiffs' position, in other words, is that §126(a) is really an unconstitutional tax on capital under the guise of a constitutional income tax.

The Government concedes that a tax on capital, as such, would be unconstitutional, but contends that this is not such a tax.

We do not propose to treat this issue in an exhaustive manner. It does not appear to us to be of a profound nature, although that is not to say that it is not equally important as any other matter that comes before the Court for determination.

Let us, first of all, dispose of plaintiffs' theory that Congress may not tax as income that which is capital under *state law*. One sentence from a recent decision of the Court of Appeals for the Sixth Circuit will suffice. It reads as follows: "If jurisdiction of this Court inhered by virtue of diversity we would be bound by Michigan Law. Such is not the case."[2] The case at bar is one where jurisdiction does not inhere by diversity.

Next, we reach the point urged by plaintiffs that the mere labeling of capital as income does not make it so. We agree that change in appellation does not work a change

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[1] Plaintiff's brief, first page.

[2] Fetter v. United States, — F. (2d) —, (6 Cir., August 10, 1959).

in the nature of that which is denominated. However, whether or not a given sum of money is capital or income is related to vantage point—from where is this sum of money being viewed? From whose perspective is it being viewed? It is not true that all capital was income at some point in time? Is it not a question involving "when" and "whom"? Are we not engaged in a controversy over semantics?

We do not perceive any real clash with constitutional rights in the application of the statute in question to the facts in the case at bar. The taxpayer here saw fit to accrue the interest during his lifetime without ever becoming the recipient himself. When upon his death the accrued interest inured to his estate, §126(a) became effective as to it, resulting in the imposition of an income tax on the moneys representing the accrued interest which, in fact, had not previously been subject to income tax. It is not disputed that the accrued interest was an item of income for the year in which it was received by the estate. As the Government points out in its brief, if the argument advanced by plaintiffs be sustained, then a decedent whose method of income accounting is by accrual gains a distinctly favored treatment by comparison with one on a cash basis.

Plaintiffs argue that the case of Dixon v. United States, 192 F. (2d) 82, (6 Cir., 1951), does not hold §126(a) to be constitutional, that such issue was not before the Court, and that this Court is, therefore, given no precedent by virtue of the Dixon case. The Court of Appeals per curiam affirmance (192 F. (2d) 82) recites that the judgment appealed from is "in all things affirmed upon the grounds and for the reasons set forth in the Findings of Fact and Conclusions of Law of the District Judge filed in the District Court on October 19, 1950, 96 F. Supp. 986." We believe that this is an endorsement, carte blanche, of the grounds and reasons set forth by District Judge Ford. The paragraph that we believe is of particular pertinence here is paragraph II of the Conclusions of Law which we here set forth in its entirety.

"II

The amount of $16,895.25 received by the decedent's estate in 1946 from the sale of the accounts receivable represented income taxable to the decedent's estate in that year. This issue is decided in accordance with the decisions in the cases of *Basch v. Commissioner*, 9 T. C. 627, and *Estate of O'Daniel v. Commissioner*, 10 T. C. 631, to the effect that *profits and income received by a decedent's estate is taxable income to the estate, in the year received, in the same manner they would have been taxable to decedent had he lived and received them.* (Italics supplied.) The Commissioner of Internal Revenue was correct in assessing and collecting the taxes on the $16,895.25, and the plaintiffs' complaint with respect to this issue is now dismissed."

*Dixon v. United States*, 96 F. Supp. 986, 988.

It seems to us that implicit in said language is the holding that the treatment of the accrued income as income rather than as capital is not illogical or unrealistic. Whether or not the ultimate distribution to beneficiaries of a decedent's estate is regarded by them as capital is of no consequence from the viewpoint of analyzing the constitutionality of §126(a). The net distribution may be capital, but it certainly is not capital before the applicable income tax law has had its impact. And we are unable to see any unfairness in the statutory scheme here employed as applied to this case. We do not believe that the taxpayer may here successfully argue the unconstitutionality of §126(a) in order to avoid income taxes on what is most clearly income that has not been taxed as income, and would not be so taxed but for the enactment known as §126(a). When the Court of Appeals affirmed the holding of the District Court by the use of the language "• • • in all things affirmed • • •" the appellate court ipso facto included paragraph II of the conclusions of law of the lower court. Paragraph II is clear in holding that the subject of the tax imposed by §126(a) was income. The subject of the tax here is of the same character and we

therefore hold it to be income. The tax under attack here is, of course, conceded not to be unconstitutional as applied to income. We believe that the per curiam affirmance of the Dixon case, supra, by the Court of Appeals for the Sixth Circuit, impels the conclusion we reach here.

An order may be presented accordingly.

By: /s/ Thomas P. Thornton,
United States DistrictJudge.

Dated: September 25, 1959.

## JUDGMENT ORDER

(Entered June 22, 1960)

At a session of said court held in the Federal Building, Detroit, Michigan, this 22nd day of June, 1960, A. D.

Present: The Honorable Thomas P. Thornton, United States District Judge.

This cause, having been submitted to the Court on a stipulation of facts and briefs, and a decision having been rendered in favor of the defendant, United States of America, on the 25th day of September, 1959, it is hereby ordered and adjudged:

1) That judgment be entered in favor of the defendant, United States of America, with the costs of this action dismissing the complaint with prejudice as to plaintiffs, Ard E. Richardson, Jr., Mildred Q. Richardson, Peter C. Treleaven, individually, and Peter C. Treleaven, Ard E. Richardson, Jr., and Wilbur M. Seelye as Co-Executors of the Estate of Irene B. Treleaven, deceased, for the claims contained in Count I of the complaint.

2) That judgment be entered in favor of the plaintiffs, Peter C. Treleaven, Ard E. Richardson, Jr., and Wilbur M. Seelye, as Co-Executors of the Estate of Irene B. Tre-

leaven, deceased. in the amount of Eight Thousand Nine Hundred Forty-Two Dollars and Seventy-Six Cents ($8,942.76), with interest as allowable by law from the date of April 18, 1950 for the claims contained in Count II of the complaint and for the allowance of the deduction of additional atorneys' fees incurred in the prosecution of this action.

Dated at Detroit, Michigan, this 22nd day of June, 1960.

By: /s/ Thomas P. Thornton,
United States District Judge.

Approved:

Evans, Boyer & Luptak,
By: /s/ Jerry D. Luptak,
Attorneys for Plaintiffs,
3143 Guardian Building,
Detroit 26, Michigan.

# APPENDIX C

## OPINION OF UNITED STATES COURT OF APPEALS

No. 14356

UNITED STATES COURT OF APPEALS

For the Sixth Circuit

| | |
|---|---|
| Ard E. Richardson, Jr., and Mildred G. Richardson; and Peter C. Treleaven, individually, and Peter C. Treleaven, Ard E. Richardson, Jr., and Wilber M. Seelye, as Co-Executors of the Estate of Irene B. Treleaven, Deceased,<br>*Plaintiffs-Appellants,*<br>v.<br>The United States of America,<br>*Defendant-Appellee.* | Appeal from the United States District Court for the Eastern District of Michigan, Southern Division. |

Decided September 19, 1961.

Before: Miller, Chief Judge, Cecil and Weick, Circuit Judges.

Miller, Chief Judge. This action was filed in the District Court by the appellants to recover federal income taxes paid for the taxable year 1948, alleged to have been improperly collected by the Collector of Internal Revenue under Section 126(a), Internal Revenue Code, which deals

with the taxation of legatees with respect to income of a decedent. The facts, which were stipulated, are summarized as follows:

Ard E. Richardson, a resident of Lansing, Michigan, died testate on September 21, 1945, leaving as survivors his widow, Irene B. Richardson, who subsequently married the appellant Peter C. Treleaven, and his son, Ard E. Richardson, Jr., who, with his wife, Mildred G. Richardson, are also appellants. The Will of Ard E. Richardson was duly admitted to probate on November 13, 1945. Within the time allowed by law, Irene B. Richardson filed with the Probate Court her election to take her share of the Estate of Ard E. Richardson, deceased, as provided by the Michigan Statutes, and pursuant to such election, she became entitled to one-quarter of the net residue of the Estate under the Michigan Statute of Descent and Distribution, and Ard E. Richardson, Jr. became entitled to the remaining three-quarters of the net residue of said Estate.

Seven promissory notes, payable by The E. Richardson Corporation in the total principal amount of $139,000.00, plus accrued interest to September 21, 1945, the date of Richardson's death, in the amount of $411,593.33 were included in the assets of the Estate of Ard E. Richardson. The notes were included in the decedent's gross estate for federal estate tax purposes at the fair market value of such principal and accrued interest, and a federal estate tax was paid upon the amount thereof. The federal estate tax attributable to the inclusion of the accrued interest of $411,593.33 was $129,534.25, or thereabouts.

On February 16, 1948, the Probate Court entered an order approving as a partial distribution of the residue of the Estate the said promissory notes plus the then total accrued interest. The distribution was on the basis of one-quarter to Irene B. Treleaven, decedent's widow who had remarried, and three-quarters to Ard E. Richardson, Jr.

On June 11, 1948, The E. Richardson Corporation paid the principal and accrued interest then owing on the promissory notes in the total amount of $565,179.68, consisting of $139,000.00 principal and $426,179.68 accrued interest. Irene B. Treleaven received $34,750.00 of said principal and $106,544.92 of said accrued interest. Ard E. Richardson, Jr., received $104,250.00 of said principal and $319,634.76 of said interest. $411,593.33 of the accrued interest of $426,179.68 paid on June 11, 1948, was attributable to interest accrued as of the date of death of Ard E. Richardson, of which amount Irene B. Treleaven received $102,898.33 and Ard E. Richardson, Jr., received $308,695.00.

Ard E. Richardson, Jr., and his wife included in their 1948 joint individual income tax return as interest income the said amount of $308,695.00. They claimed in this return a deduction under Section 126(c) of the 1939 Internal Revenue Code in the amount of $92,980.50 for federal estate taxes paid by the decedent's estate and attributable to the accrued interest of $308,695.00.

Irene B. Treleaven died January 15, 1949. Appellants Peter C. Treleaven and the Executors of the Estate of Irene B. Treleaven included in their 1948 joint individual income tax return as interest income the amount of $102,898.33. In this return a deduction was claimed under Section 126(c) of the 1939 Internal Revenue Code in the amount of $30,993.50 for federal estate taxes paid by decedent's estate and attributable to the accrued interest of $102,898.33.

Claims for refund were filed by the taxpayers on the ground that the accrued interest of $308,695.00 and $102,898.33 were excluded from gross income under Section 22(b) (3) of the 1939 Internal Revenue Code as a bequest, devise or inheritance; that the income tax cost basis of this accrued interest under Section 113(a) (5) of the 1939 Internal Revenue Code, as amended, was the fair market value thereof on the date of death of Ard E. Richardson; and that Section 126 of the 1939 Internal Revenue Code, as amended, was unconstitutional insofar as it attempted to

levy an income tax on property acquired by bequest, devise or inheritance. The taxpayers also claimed a refund on the ground that they had understated the federal estate tax deduction allowed under Section 126(c). The refund claims were allowed and paid insofar as they related to additional deductions under Section 126(c); to the extent not allowed the refund claims were rejected by statutory notice of disallowance.

Timely suit for refund was filed by the taxpayers in the District Court. The trial court entered judgment for the United States holding that the accrued interest as of September 21, 1945, which was paid to the appellants in 1948, was taxable income to the appellants in 1948 under Section 126(a), 1939 Internal Revenue Code, as amended, which section of the Code he ruled was not unconstitutional. *Richardson, et al. v. United States*, 177 F. Supp. 394, E. D. Mich. This appeal followed.

Section 126(a)(1), as amended by Section 134(e), Revenue Act of 1942, provides:

> "General rule. The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period shall be included in the gross income, for the taxable year when received, of: * * *" the person who acquires from the decedent the right to receive the amount by bequest or inheritance.

Section 126(a)(3) provides that the amount includible in such gross income shall be considered "to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount."

The provisions of Section 126 have been applied in the following cases. *O'Daniel's Estate v. Commissioner*, 173 F. (2) 966, C. A. 2nd; *Dixon v. United States*, 96 F. Supp. 986, affirmed, 192 F. (2) 82, C. A. 6th; *Commissioner v. Linde*, 213 F. (2) 1, C. A. 9th; *Estate of Fred Basch*, 9

T. C. 627. Under those rulings the interest received by the appellants in 1948 was taxable income to them in that year.

Appellants concede that the interest received by them in 1948 is taxable to them under the provisions of Section 126(a) if Section 126(*e*) is valid. Their single contention is that Section 126(*e*) is unconstitutional and invalid. They point out that in the three Court of Appeals cases above referred to, the constitutionality issue was not raised or discussed, and that although the question was raised in the *Fred Basch* case in the Tax Court, it was disposed of there by merely a ruling without discussion or explanatory reasoning. We do not fully agree with this criticism of the Tax Court's ruling, since it appears from the Tax Court's opinion that reference was made to *Taft v. Bowers*, 278 U. S. 470, in support of its ruling, to which case we hereinafter refer.

Appellant's claim of unconstitutionality is based upon the contention that the interest on the notes in the present case, not having been received by the decedent, who was on the cash receipts basis, was not taxable income to the decedent, but upon his death was a property right which became part of the principal of his estate, and that any tax upon it when it was later paid and reduced to possession, was obviously a tax upon the principal of the estate. Such a direct tax can not be imposed by Congress without apportionment among the states according to population, as required by Article I, Section 2, Clause 3, and Article I, Section 9, Clause 4, of the Constitution of the United States. Article I, Section 9, Clause 4, provides:

> "No capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration hereinbefore directed to be taken."

*Pollock v. Farmers' Loan and Trust Co.*, 157 U. S. 429, 580, 583; *Eisner v. Macomber*, 252 U. S. 189. This constitutional limitation upon direct taxation was modified by the Sixteenth Amendment insofar as taxation of income

was concerned, but the amendment was restricted to income, leaving in effect the limitation upon direct taxation of principal. *Eisner v. Macomber, supra,* 252 U. S. 189, 205-206. Appellants accordingly contend that the tax imposed by Section 126(a), being a direct tax on principal without apportionment is unconstitutional. Although the tax has been in effect since 1942, we are referred by counsel for the respective parties to no Supreme Court or United States Court of Appeals case in which the constitutionality issue is discussed and expressly decided.

It is, of course, conceded by the Government that if Section 126(a) is a tax on principal, it is invalid under the foregoing well settled principles. It is also recognized that if the tax is actually one on principal, labeling it as a tax on income will not avoid the constitutional limitation. *Taft v. Bowers, supra,* 278 U. S. 470, 481; *Eisner v. Macomber, supra,* 252 U. S. 189, 206; *Hoeper v. Tax Commission,* 284 U. S. 206, 215. The Government contends, however, that the tax is a tax on income and so not within the constitutional limitation.

We first review the legislative history of Section 126.

Prior to 1934 the courts held that income accrued by a decedent on the cash basis prior to his death was not taxable in the decedent's final income tax return because it had not been received by him during his lifetime. Nor was it taxable as income to his estate because it came into the estate as *capital,* not as income. *Nichols v. United States,* 64 Ct. Cls. 221, cert. denied, 277 U. S. 584; *E. S. Heller, et al., Executors,* 10 B. T. A. 53; *William K. Vanderbilt, et al., Executors,* 11 B. T. A. 291. See: *Helvering v. Enright,* 312 U. S. 636, 639, Note 6.

In order to plug this loophole, it was provided by Section 42 of the Revenue Act of 1934, 48 Stat. 680, C. 277, "In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death, if not otherwise properly includible in respect

of such period or a prior period." *Estate of Putnam v. Commissioner*, 324 U. S. 393, 396-397.

The Supreme Court held in *Helvering v. Enright, supra*, 312 U. S. 636, that Section 42 of the Revenue Act of 1934 permitted the inclusion as accruable items, in a decedent's gross income for the period ending with his death, his share of the profits earned, but not yet received, of a partnership, when both the decedent and the partnership reported income on a cash receipts and disbursements basis.

Section 42 of the 1934 Revenue Act resulted in some hardships because there were bunched in the final income tax return of a decedent items of accrued income which might be collected later at different times over a period of years. This subjected such accrued income to higher tax rates than would be the case if returned in the different years in which they were later received. Accordingly, in the Revenue Act of 1942 Congress enacted Section 126 of the Internal Revenue Code, which is applicable to the present case, and under which the accrued interest on the notes was made taxable in the year received to the person who acquired from the decedent the right to receive it by bequest or inheritance. The question is, did the appellants receive this interest as taxable income or as a nontaxable inheritance of principal?

The Sixteenth Amendment did not define the word "income." The Supreme Court in *Eisner v. Macomber* approved the following definition, "Income may be defined as the gain derived from capital, from labor, or from both combined," provided it be understood to include profit gained through a sale or conversion of capital assets, pointing out the fundamental conception clearly set forth by the wording of the Amendment which gave Congress the power to collect taxes "on incomes, from whatever source derived." 252 U. S. at pages 207-208; *Taft v. Bowers, supra*, 278 U. S. 470, 481.

Under the definition of income above referred to, the accrued interest on the notes in the present case was income. *Section 22(a), 1939 Internal Revenue Code; Helver-*

*ing v. Midland Mutual Life Ins. Co.*, 300 U. S. 216, rehearing denied, 300 U. S. 688; *Austin v. Commissioner*, 161 F. (2) 666, C. A. 6th, cert. denied, 332 U. S. 767. Whether it was taxable to the decedent was a question for Congress to determine, involving no constitutional issue. *Flint v. Stone Tracy Co.*, 220 U. S. 108, 173; *Brushaber v. Union Pacific R.R. Co.*, 240 U. S. 1, 21, 24-26; *Commissioner v. Jacobson*, 336 U. S. 28, 49. If decedent had been on an accrual basis for income tax purposes, it would have been taxable income to him. Since decedent was on a cash receipts basis, Congress did not make it taxable to him prior to 1934. Although nontaxable, it was nevertheless income of the decedent. In 1934 Congress made it taxable income to a decedent in a situation like the present one. Such legislation was held valid in *Helvering v. Enright, supra*, 312 U. S. 636, the Court pointing out that it was the intent of Congress to cover into income the assets of decedents, earned during their life and unreported as income, which on a cash return, would appear in the estate returns, thus providing a fair reflection of decedent's income.

Section 126(a), enacted in 1942, embodies an analogous principle. Although the accrued interest was income it was not made taxable to the decedent, but was made taxable to the person who actually collected it at the time when it was collected. Section 126(a)(3) provides that the amount included in the gross income of the person who acquired from the decedent the right to receive the amount by bequest or inheritance, shall be considered in the hands of such person "to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount." If the decedent had lived and received the interest, it would have been taxable income to him. We do not think it was an unconstitutional exercise of power for Congress to exact the payment of the income tax on what is clearly income from the person who actually received the income rather than from the decedent, as was previously required under Section 42 of the Revenue Act of 1934. This, we believe, is the effect of the ruling in *Taft v. Bowers, supra*, 278

U. S. 470. We construe that case as holding (pp. 482-483) that Congress in so doing deprives a taxpayer of no right and subjects him to no hardship, in that the taxpayer receives the income with knowledge of the statute and of the tax thereunder inherent in it at the time of its receipt. See also: *United States v. Phellis,* 257 U. S. 156, 171-172. It will be noticed that in enacting Section 126 Congress provided by Subsection 126(c) for a deduction against the tax for federal estate taxes paid and attributable to the inclusion of an amount in gross income under Subsection (a) which deduction appellants claimed and received,

Under the rulings in *Helvering v. Enright, supra,* and *Taft v. Bowers, supra,* we hold that the tax in question was a tax on income rather than a tax on principal, and accordingly is not unconstitutional.

The judgment of the District Court is affirmed.

## JUDGMENT

(Filed September 19, 1961)

Appeal from the United States District Court for the Eastern District of Michigan.

This cause came on to be heard on the transcript of the record from the United States District Court for the Eastern District of Michigan, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be and the same is hereby affirmed.

Approved for entry:

/s/ Shackelford Miller, Jr.,
Chief Judge, U. S. Court of Appeals.